STATUS REPORT TO THE LEGISLATURE:

NEW INPATIENT HOSPITAL CARE PAYMENT METHODOLOGY BASED ON DIAGNOSIS-RELATED GROUPS

April 1, 2011 Report

Department of Health Care Services
Safety Net Financing Division

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I. Background Information

Senate Bill 853 (Chapter 717, Statutes of 2010), the 2010 health budget trailer bill, added Section 14105.28 to the Welfare and Institutions Code to require the Department of Health Care Services (DHCS) to implement a new payment methodology for inpatient hospital care in the Medi-Cal program based upon diagnosis-related groups (DRG), on the date that the replacement Medicaid Management Information System becomes fully operational, but no later than June 30, 2014.

The DRG payment methodology is subject to federal approval and must reflect the costs and staffing levels associated with quality of care for patients in all general acute care hospitals in state and out of state, including Medicare critical access hospitals, but excluding public hospitals, psychiatric hospitals, and rehabilitation hospitals (which include alcohol and drug rehabilitation hospitals).

In evaluating the alternative DRG algorithms for the new Medi-Cal reimbursement system, DHCS is required to consider all of the following factors:

- The basis for determining DRG base price, and whether different base prices should be used taking into account factors such as geographic location, hospital size, teaching status, the local hospital wage area index, and any other variables that may be relevant.
- Classification of patients based on appropriate acuity classification systems.
- Hospital case mix factors.
- Geographic or regional differences in the cost of operating facilities and providing care.
- Payment models based on DRG used in other states.
- Frequency of grouper updates for the DRG.
- The extent to which the particular grouping algorithm for the DRG accommodates ICD-10 diagnosis and procedure codes, and applicable requirements of the federal Health Insurance Portability and Accountability Act of 1996.
- The basis for calculating relative weights for the various DRG.
- Whether policy adjusters should be used, for which care categories they should be used, and the frequency of updates to the policy adjusters.
- The extent to which the payment system is budget neutral and can be expected to result in state budget savings in future years.
- Other factors that may be relevant to determining payments, including, but not limited to, add-on payments, outlier payments, capital payments, payments for medical education, payments in the case of early transfers of patients, and payments based on performance and quality of care.

California currently pays hospitals based upon one of three methodologies:

- Hospitals that contract through the Selective Provider Contracting Program (SPCP) negotiate a per diem rate with the California Medical Assistance Commission (CMAC) through confidential negotiations.

- Hospitals that do not contract through the SPCP are reimbursed for their allowable costs. Non-contract hospitals can only provide emergency services unless they operate in a health facility planning area that has been deemed as open by CMAC.

- Designated Public Hospitals (DPHs) receive federal funding based on their certified public expenditures. Since DPHs do not receive state reimbursement, they are excluded from the provisions of SB 853.

Currently, roughly two-thirds of Medicaid programs around the country have adopted some form of a DRG payment methodology. A DRG payment methodology reimburses hospitals depending on a patient's clinical characteristics. Instead of receiving higher reimbursement by providing more services or having longer stays, hospitals make more profit under a DRG payment methodology by becoming more efficient.

II. Purpose of the Update

Section 14105.28 of the Welfare and Institutions Code requires DHCS to submit to the Legislature a status report on the implementation of the DRG payment system on April 1, 2011, April 1, 2012, April 1, 2013, and April 1, 2014. This report provides a status update for April 1, 2011.

III. Key Milestones and Objectives

The following key milestones and objectives have been completed since SB 853 was enacted on October 19, 2010:

- DHCS is initiating a sole source contract with Affiliated Computer Services (ACS) to aid in the development of the DRG payment system. ACS is in the process of taking over responsibility as the Medi-Cal Fiscal Intermediary and has been involved in the development of multiple states successfully implementing a DRG payment system.

- Two DHCS staff have been redirected to facilitate the development of the DRG payment system.

- An internal workgroup consisting of DHCS and CMAC staff was established and will begin meeting on a monthly basis beginning in April 2011.

- An external workgroup consisting of hospital representatives was formed and will meet within a week of every internal workgroup meeting to ensure transparency of the development of the DRG payment methodology.

- DHCS is compiling 2007-08 data from the Office of Statewide Health Planning and Development and Medi-Cal claims data that will be trended and used to make comparisons with the new DRG methodology. This process will assist in identifying baseline data to help establish cost reimbursement levels.

- DHCS is organizing a briefing for Legislative staff to occur on May 25, 2011, to provide an overview of the key decision points in developing a DRG payment methodology.

IV. Key Implementation Issues

There are a myriad of policy issues that need to be decided upon to develop the DRG payment system. Issues of concern include, but are not limited to, making special allowances for:

- Wage areas
- Hospital size
- Teaching status
- Anticipation of improved documentation and coding
- Supplemental payments
- Transitional base prices
- Outlier payments
- Variance restrictions from the current payment methodologies

Reaching consensus on these issues is likely to be difficult; however, the internal and external workgroups will be tasked with consideration of all components involved. As this is the first status report, there is limited information available.